Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Goldilocks Returns – For Now !

The global purchasing managers indexes have been sliding since the beginning of 2018 (Markhit PMI), with the Manufacturing PMI currently in contraction territory. The US has slowly been following suit, with two consecutive recent manufacturing ISM PMIs below 50 (August ISM Manufacturing came in at 49.1 and September at 47.8). Numbers below 50 represent manufacturing in a contractionary phase.

Initially, with the latest September report, the market was spooked and corrected. After correcting sharply on Tuesday and Wednesday of the first week in October, the S&P 500 increased slightly, on Thursday, ahead of the Nonfarm payroll report to be released on Friday. On Friday, the Nonfarm payroll report did not disappoint, with a weaker than expected jobs report coming in at 136k vs an expected 145k. In 2019, the Nonfarm payroll reports have shown a declining trend.

The stock market cheered the latest weak Nonfarm payroll report because it meant that the Federal Reserve was more likely to cut its federal funds rate at its next meeting on October 30th. The bad news was treated as good news and boosted the stock market.

S&P 500 - Technical Status

The S&P 500 is still in its upward trading channel, despite causing some angst in second half of September and the beginning of October. Since late last year, falling interest rates have helped to propel the stock market higher, with some corrections along the way. When interest rates turned lower at the beginning of October last year, technology stocks turned lower compared to the S&P 500 (XLK:$SPX). Last year, at this time the semiconductor sector had already turned down on a relative basis compared to the technology sector (SMH:XLK), indicating weak market conditions. This year, we are poised with a similar setup for the technology sector, but it has not broken lower on a relative basis compared to the S&P 500. Also, the semiconductor sector is currently performing well. So far, these sectors have not confirmed possible "trouble" ahead in the stock market as they did last year.

This year, junk bonds have been underperforming corporate bonds since October (JNK:LQD) as bond investors have been concerned about a slowing economy. Not a timing signal, but an indication of concern. Currently, the S&P 500 is still in a rising trend channel. The concern is if the S&P 500 breaks below its rising trend line at 2800, just below the 200 day moving average.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **September 30th,** 2019

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	20.4%
	Bond	
HFR	Horizons Active Floating Rate Bond ETF	10.1%
	Commodities	
HURA	Horizons Global Uranium Index ETF	0.5%
HUN	Horizons Natural Gas ETF	1.9%
	United States Dollar Exposed Assets	
	Short Term & Bond	
DLR	Horizons US Dollar Currency ETF	51.8%
HUF	Horizons Active US Floating Rate Bond (USD) ETF	1.0%
	Equities	
XLP	Consumer Staples Select Sector SPDR Fund	8.7%
XLV	Healthcare Select Sector SPDR Fund	4.3%
	US Dollar Forwards (Oct 2019) - Currency Hedge **	-0.4%
	Cash, Cash Equivalents, Margin & Other	1.7%
	Total (NAV $306,789,996)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 17.2% of current NAV)

The objective of HAC is long-term capital appreciation in all market cycles by tactically allocating its exposure amongst equities, fixed income, commodities and currencies during periods that have historically demonstrated seasonal trends. The Thackray Market Letter is for educational purposes and is meant to demonstrate the advantages of seasonal investing by describing many of the trades and strategies in HAC.

This scenario is a Goldilocks scenario where the data is neither too weak nor too strong to cause concern over the economy.

At the beginning of last week, investors had a probability of 49% that the Federal Reserve would cuts its Federal funds rate by 25bps at its next meeting on October 30th. At the end of last week, after the Nonfarm payroll report, the expectation adjusted upwards to 78% (CME Group).

When bad news is seen as good news, it is a positive for the stock market as it is an expression of positive investor sentiment. So, the stock market's rally on weak Nonfarm payroll was positive, at least in the short-term. Goldilocks has returned once again to stock market, where the economic conditions are not too hot to stimulate the Federal Reserve to become hawkish, and not too cold to spike recessionary fears.

The problem is that there has been diminishing returns from investors reacting positively to Federal Reserve liquidity increases in the markets. With the initial tranches of QE (many years ago), the stock market blasted higher for long periods of time. Over time, monetary policy has been seen to be less and less effective, and stock market rallies have been shorter and shorter with looser policy actions.

It is not just about the stock market. The economy drives the stock market. Businesses do not dramatically alter their behavior if interest rates move from being low over an extended period of time to very low, "lower low rates" do not matter much. This is one of the reasons why the ECB has instituted a program of negative interest rates. This policy is based on the belief that banks/businesses/individuals will spend money in order to avoid their savings being confiscated. Ironically, savings have increased recently in the Eurozone because investors now need to save more in order to finance the future.

It is always hard to tell how long Goldilocks is going to stay and help support the stock market. Investors would be wise to not become too optimistic due to any further loose monetary policy by the Federal Reserve. With smaller and smaller expected benefits from Federal Reserve action.

It is entirely possible that Goldilocks may only stay in the stock market for a while. The large rally in the stock market on Friday October 4th was in part a lot of short covering. If investors shift to a bearish stance in the stock market relatively quickly and Goldilocks only stays for a while, expect more volatility in the month of October.

Seasonally– Volatility equals Opportunity

Large drops in the stock market in October have historically, on average, been good opportunities to increase equity positions in a transition from the six-month unfavorable period for stocks (May 6th to October 27th) to the six-month favorable period (October 28th to May 5th).

Last year, the dips in the stock market in October were not good buying opportunities as the stock market corrected after each recovery from a dip. The stock market continued to erode all the way until late December.

At the beginning of October last year, the S&P 500 was at an all-time high. In this scenario, it is typically best to be patient entering into the stock market and be cautious and conservative on the dips. This year, the S&P 500 is close to an all-time high, and as such, is similarly positioned as it was last year. Accordingly, the best strategy is to probably be cautious and conservative transitioning into the six-month favorable period for stocks that starts on October 28th.

At the time of writing this section of the newsletter, Powell just announced a monetary program that is supposed to help with liquidity in the market place. Playing Voldemort from "Harry Potter" he insisted that the new program NOT be called quantitative easing (QE4).

The new monetary program shall not be named!

Really, what is Powell trying to do, the Federal Reserve's next meeting is on October 30th? Why not announce the program at that time? Evidently, a lot of investors were concerned and sold the market. Powell runs the risk of scaring investors. One more reason to be cautious at this time transitioning into the stock market for the six-month favorable period for stocks which starts on October 28th.

What the HAC?

In the month of September, HAC exited its successful seasonal trades in gold, fixed income and REITs. At the end of the month, HAC held a large amount of cash and cash equivalents. The six-month favorable period for stocks starts later in October and historically HAC has increased its equity exposure approximately at that time.

Seasonal Opportunities

Gold– Finished for Now - "We'll be back"

Gold bullion has it first seasonal period of strength from July 12th to October 9th and a second seasonal period of strength December 27th to January 26th

Gold bullion is just finishing its first seasonal period. It has been a successful seasonal period. The bad news is that the rest of October tends to be a weak period for gold bullion. Given that lower interest rates have been one of the major drivers of a higher price for gold and the seasonal period of declining interest rates just finished on October 3rd, it is possible that gold could consolidate at this point.

So far, on a technical basis, gold has not broken its upward trend line on an absolute or relative basis compared to the S&P 500. If gold were to break below its upward trend lines, it would be expected that gold could correct in the short-term.

The good news is that gold has second seasonal period just around the corner. Gold tends to perform well on a seasonal basis from December 27th to January 26th. This seasonal trend has worked well over the last few years. This seasonal phenomenon is largely caused by Chinese buying gold into the Chinese New Year.

> My Call: Gold bullion will probably be flat over the next two months, before presenting a good seasonal opportunity in mid-to-late December.

Gold miners– Careful, already showing signs of breaking

The gold miners sector has its first seasonal period of strength from July 27th to September 25th and a second seasonal period of strength from December 23rd to February 14th

Gold miners performed well in their first seasonal period which finished on September 25th. Since late September, the gold miners sector has been showing weakness on an absolute basis and relative to the S&P 500. Given that the sector has broken its upward trend lines, caution is advised. The good news is that like gold bullion, gold miners have a second period of seasonal strength that starts in late December.

> My Call: Gold miners will probably underperform the stock market into mid-December.

Government Bonds– Seasonal period of strength just ended

US government bonds have performed very well in their seasonal period, which lasted from May 6th to October 3rd. It is possible that the sector could continue to perform well, particularly if the "world falls apart," but everything else being equal, US government bonds usually taper off at this time of the year.

Last year bonds started to perform well as interest rates

peaked in early October and plunged for almost a year. Sure, this could happen again, but the seasonal winds do not support such a move.

Technically, US government bonds have not broken their upward trend line on an absolute basis. If this line is broken, US government bonds will likely start a trend of further erosion.

My Call: US government bonds will probably be slightly negative until the end of the year, before correcting sharply in the new year.

REITs- Good Economic Environment....but seasonally time to say goodbye

The economic environment for REITs has been positive, with a stable economy and low interest rates. The seasonal period for REITs is from May 20th to September 20th. This year, in their seasonal period REITs performed well.

My Call: The REIT sector will probably continue to perform moderately well past its seasonal period but taper off in November.

Technology

The technology sector has seasonal periods of strength from October 9th to December 5th and December 15th to January 17th

Currently, the technology sector has been forming the same pattern as it did last year at this time. The technology sector breakdown last year was a precursor to stock market trouble. Right now, the technology sector is on the verge of breaking below its upwards trendline (oops). Last year the break of the trendline was the result of potential government action against the monopoly nature and censoring of the major technology companies. Although the sector has the same issue of government action to deal with, it also is grappling with the effects of the trade war between the US and China.

The seasonal technology trade typically plays out well, but so far the trade has not shown relative strength compared to the S&P 500 as its seasonal period of strength starts.

My Call: The technology sector will probably start to work shortly and the sector will probably moderately outperform the S&P 500 until early December.

Semi-conductors– Makes no sense to me.....but positive

Semiconductor sales have been weak, but semiconductor stocks have been rising in price and outperforming the S&P 500 since the summer time. A lot of the strong performance has been built on the optimism of internet for everything etc. Nevertheless, it is what it is, and the trend has to be respected. It could be that if and when, the semiconductor sector breaks lower relative to the S&P 500 that this is a signal of a weaker overall stock market. Right now, spec money (speculative investment money) is alive and well.

Technically, the semiconductor sector has been forming bullish ascending triangles on an absolute basis and relative to the S&P 500. This process of higher lows, often breaks to the upside. There is a caveat, other than the technical formation does not always work, the tighter the formation into the acute angle of triangle, the greater the chance of the pattern failing to the downside.

As the sector has been advancing higher, volume has been shrinking, indicating a lack of conviction in the positive price move. In the bottom panel of the graph below, I label the relative price performance compared to the S&P 500 as "Now or Never" at the breakout point in the corner of the apex. A move higher at this point, on strong volume would be positive for the sector, as it would indicate a break above "flat" performance over the last two years. A move back below this breakout level would be bearish for the sector.

My Call: The semiconductor sector will probably break above its resistance level in the near term.

Canadian Banks– Value play?

Canadian banks have a seasonal period from October 10th to December 31st, and then from January 23rd to April 13th

Canadian banks have been underperforming the S&P/TSX Composite Index from last October to September. In other words the sector has been underperforming for almost a year. Recently the sector has started to show both absolute strength and relative strength compared to the Canadian stock market. Although the Canadian banking sector is susceptible to an economic slowdown, investors find comfort in the high dividend for the sector, approximately a 4.6% average. In the current economic environment, Canadian banks could muddle through their seasonal period.

On a technical basis, the Canadian banking sector has risen above its trend line relative to the Canadian stock market, which is a positive sign. Nevertheless, it is important to watch for the sector to break back below its relative trend line, which could indicate future weakness in the sector. Overall, the sector is currently favorable compared to the stock market.

My Call: The Canadian banking sector will probably outperform the Canadian stock market until the end of the year.

Industrials- Lack of interest

The industrials sector has a strong seasonal period from October 28th to December 31st

The industrial sector has been underperforming the broad stock market mainly due to the US-China trade war and

slowing global growth.

The industrial sector on an absolute basis has been in a trading range since 2018. Recently, on an absolute basis, the sector has been forming a pattern of higher lows, which is positive. On the other hand, the sector relative to the S&P 500, has been underperforming and has been forming a trend of lower highs.

Ideally, as the industrial sector begins its seasonal period, a break above the relative trend line would signal improving momentum in this sector.

The industrial sector can re-rate its price fairly fast compared to the stock market and then consolidate against the market for an extended period of time. Ideally speaking it is often best to be positioned to take advantage of this scenario before it happens.

My Call: The industrial sector will probably perform at market until late October and then outperform until the end of the year.

Materials- Maybe not yet

The materials sector has a strong seasonal period from October 28th to January 6th

The materials sector has been negatively affected by slowing economic growth and the US-China trade war. Nevertheless, the sector has performed at market and on an absolute basis has created a bullish pattern of higher lows.

On an absolute basis the material sector is at support on its rising trade line. Relative to the S&P 500, the materials sector is currently in mid-range.

Ideally, a break above its trading range relative to the S&P 500 would be a bullish signal for the sector.

My Call: The materials sector will probably continue to perform at market or slightly better than market until late January when the sector starts its next seasonal period.

Metals and mining

The metals and mining sector has a seasonal period that starts on November 19th until January 5th

The metals and mining sector has formed a decisive trend of lower highs both on an absolute basis and relative to the S&P 500. At this time it is best to be patient in waiting for the seasonal trade to start.

My Call: The metals and mining sector will probably continue to underperform until mid to late November.

Home Builders

The home builders sector has a strong seasonal period from October 28th to February 3rd

On a technical basis, the sector has been performing well on an absolute basis and relative to the S&P 500. The sector has performed particularly well since the beginning of the year.

The sector has benefitted from the Federal Reserve's policy of lowing its federal funds rate, making mortgages cheaper. The difficulty in executing the homebuilders trade in this seasonal period is that the extent of the home builders rally has been very strong and if the Federal Reserve were to temper rate reduction expectations, the homebuilders sector could correct, despite being in its seasonal period. Typically, in this type of scenario it is best to be cautious with the trade.

My Call: The homebuilders sector will probably slightly outperform the stock market.

Transportation

The transportation sector has a seasonal period that lasts from October 10th to November 13th

The transportation sector has been on a slow grind lower on an absolute basis since the beginning of 2018. On a relative basis compared to the S&P 500, the sector has been grinding lower since the beginning of 2019. Given its underperformance, investors should be cautious with this sector of the stock market.

My Call: The transportation sector will probably bounce of its bottom trading channel relative to the S&P 500 until mid-November.

Consumer Discretionary

The consumer discretionary sector has a strong seasonal period from October 28th to mid-April

The consumer discretionary sector is still in its rising trend channel on an absolute basis and relative to the stock market. Although the consumer is starting to show declining sentiment about the future, consumer spending has not eroded substantially at this point. This is despite weakening manufacturing and service PMIs.

My Call: The consumer discretionary sector will probably continue to outperform the stock market over the next few months.

Retail– Not dead yet

The retail sector has a strong seasonal period from October 28th to November 29th

Below I have included two charts of different retail ETFs. This is a good illustration to show how the underlying constituents can make a difference in price patterns.

The XRT ETF is an equally weighted security with holdings averaging approximately 1.5% each. This ETF is largely focused on bricks and mortar stores.

The XRT sector has been on a declining trend on an absolute and relative basis compared to the S&P 500. Recently, the sector has been showing signs of breaking out, but barely. A breakout on an absolute basis would be a positive technical signal.

My Call: The retail sector (XRT) will probably moderately outperform the broad market during its seasonal period.

The RTH ETF has performed much better than the XRT ETF, due to its different underlying constituents. The top three holdings in RTH are currently Amazon, Home Depot and Walmart which makes up approximately 40% of the fund.

On an absolute basis RTH is in an upward trading channel. On a relative basis, the sector has been performing at market, but is at the top of the trading channel. Overall, the technical picture is positive.

Agriculture– Stealth performance

The agriculture sector has a strong seasonal period from September 26th to November 11th

Despite the trade war taking place between the US and China, the agriculture sector has held up relatively well.

The agriculture sector has been trading sideways relative to the S&P 500 since 2017. It is currently at the bottom of its trading channel. If the sector starts to bounce off the bottom of its relative trading channel, this would be a positive technical signal.

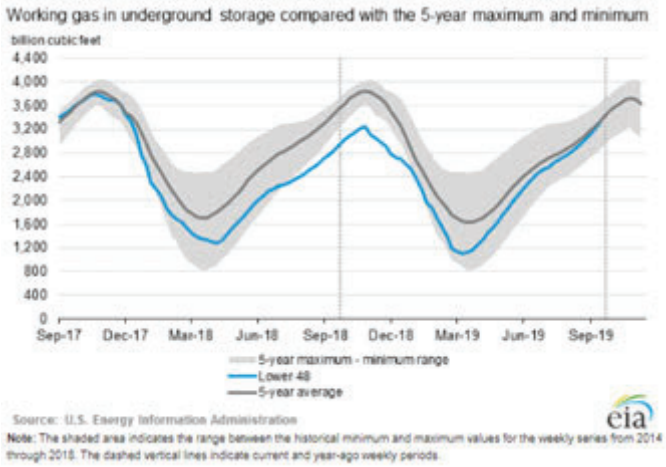
My Call: The agriculture sector will probably moderately outperform the S&P in its seasonal period.

Natural Gas- On Simmer - For Now

The natural gas seasonal period lasts from September 5th to December 21st

Natural gas started its seasonal run a bit early this year. In late September, natural gas started to pull back, but it has not broken below its support level, nor has it broken back below its downward trend line.

In the short-term, natural gas trades somewhat on weather. Commodities traders follow many different weather models. It is very difficult to predict the impact of weather on the price of natural gas. As weather is realized its affects are automatically embedded in the price. Likewise, the inventory level relative to the five year average is also embedded into the price of natural gas. Nevertheless, in situations where the current inventory level is above the five year average, the natural gas price is susceptible to larger drops in price than if it is below the five year trend line.



My Call: Last year, the inventory level of natural gas was substantially below its five year average, which lead to a very volatile price pattern and a successful trade. This year, given that natural gas inventory level is close to its five year average, the same degree of volatility is not expected. Nevertheless, natural gas will probably start to consolidate before moderately breaking higher in late October and November.

Stocks

Cameco– Possible break out coming up

Cameco has a seasonal period from October 4th to December 24th

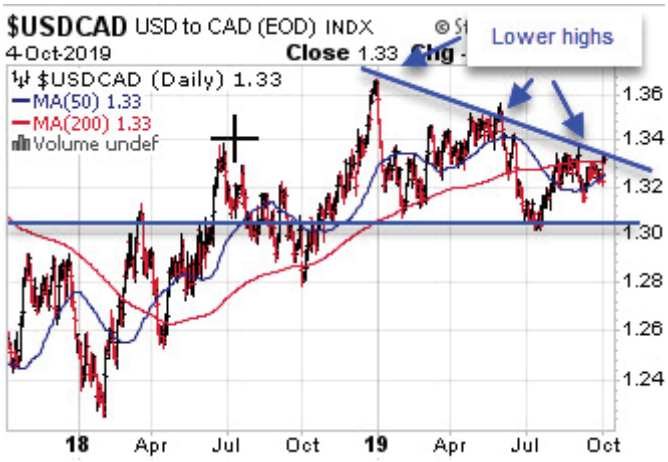
Cameco has been in a downtrend since early 2019 and has been underperforming the S&P 500 over the same time period.

Cameco tends to start its seasonal period of strength after the World Nuclear Conference takes place in September. Last year, Cameco performed well in this seasonal period. So far, the sector has been performing at market. If Cameco were to break above its downward trend line, this would be a positive development for Cameco, setting up well for its seasonal period.

Currency Corner

USDCAD– Watch for breakout

The US dollar has a strong seasonal period from September 26th to December 19th



Recently, the US dollar has been showing strength at the beginning of its seasonal period. The US dollar will probably move one way or another relative to the Canadian dollar towards the end of the month. The Federal Reserve has its next meeting on October 30th and the Bank of Canada has its meeting on October 31st. Investors should expect a lot of volatility in the US dollar at this time.

The US dollar, has been sliding relative to the Canadian dollar since the beginning of the year. On a bearish note, the US dollar has been forming a pattern of lower highs. Currently, the US dollar is up against the top of the trend line of the highs. Given that the US dollar has just started its seasonal period, it often breaks out to the top side in this pattern.

My Call: The US dollar will probably break higher in October and November, but finish its strong seasonal period in early December.

Brooke's Rant

WeWork — WeSpend — WeInTrouble

I am writing this rant while sitting at a table in a WeWork office. It is a great facility. All of the flavored water, coffee, kumbucha and beer that I want....free. I am on the road for meetings so I am a guest at the facility.

I am definitely out of place with a suit and tie in a "office" that is filled with mostly millennials in T-shirts, hoodies and hats. Nevertheless, it is a "cool" place, with a good "work buzz."

WeWork is a great facility, but probably not a good investment at a rich IPO price. Just like Tesla may be a great car, but not necessarily a good long-term investment: WeWork may be a great place to "hotel" your work, but not a great investment opportunity.

So what is the problem? Without discussing the behavior of past executives of WeWork and possible money abuses, investors became "WeWoke" and realized that the IPO that was supposed to be launched recently was priced "way out of whack." WeWork is currently bleeding money and won't make any profits until sometime in eternity, or never, which every you prefer.

You may say WeWork has a first mover advantage and like Amazon, should be given an extended period of time to grow. Sorry, not the same. First of all, there are other large rentable work offices such as Regus, which has over 3,000 locations in 120 countries. Regus trades on the London Stock Exchange at a substantial discount to WeWork's IPO metrics. Second, Amazon was able to build a protective moat around its business by creating a logistics system that would require billions of dollars to compete against it. This is definitely not the case with WeWork. In fact, it is probably the opposite as competition will increase if the economy slows down or goes into a recession.

WeWork has fixed costs in the mid to long term with their leases. Right now, office space is hard to come by in many cities and is extremely expensive, but that will change. In a recession, renting office space becomes extremely cheap. Not only do companies rationalize their costs by laying off employees and cutting office space, but new supply continues to come on the market at the worst time. It takes many years to plan and build office buildings. Developers do not halt their construction of a partially completed building. The sunk costs would "sink" them. They have to finish, bringing new office properties to the market at the absolute worst time. The end result is falling office rental prices.

WeWork is not much different that an uber "Starbucks," minus some meeting rooms and other facilities. In my casual research, most users appear to using the facilities as a desk workspace with free wifi. The underlying problem is that in a recession companies and entrepreneurs will quickly cancel their WeWork obligations. Employees and entrepreneurs will have to shoulder some of the cost cutting by working at Starbucks. If WeWork is not making money in good times, how are they going to make money in a recession?

MillenialWork

In the next recession, I am starting "MillenialWork" (sarcasm). Nevertheless "copycat" competition to WeWork will be established in the next recession.

The best time to start an office sharing company is in a recession, as owners of office buildings desperate to cover the cost of operations will offer great bargains. WeWork has absolutely no protective moat against competition. It is extremely easy to duplicate.

All that you need to start a competing company to WeWork is a wifi router, desks, extension cords, coffee machine and a case of beer. That is it folks. Now you are competing against WeWork.

When things are going great, they are great. No one questions the underlying assumptions. Milton Friedman, many years ago in his article "The Euro: Monetary Unity To Political Disunity?", said that the euro will work when the economy is good, but will falter in a difficult economic environment. He was right.

WeWork is not much different. In an expanding economy, a lot of sins are hidden. In good economic times, debt does not matter that much, especially with low interest rates. When a recession hits, WeWork could be in serious trouble. The underlying problem is that there is a mismatch between the long-term real estate liabilities and the short-term commitments of its occupants. It is a recipe for a disaster.

So why am I ranting about WeWork?

Investors are starting to become "WeWoke," and are starting to appreciate the amount of risk in many different parts of the investment markets. This year, many unicorns have faltered as investors have not always blindly accepted the axiom that first mover advantage means that the company will rule the world. The WeWork IPO was "delayed" as investors woke up to the possibility that it was dramatically overpriced and questions of management integrity did not help. If WeWork is able to launch an IPO, it will probably be at a much lower price than its previous attempt.

Right now, a lack of respect for risk still exists in the market: a large number of junk bonds are being issued at much lower interest rates than would be expected in "normal times" and almost half of the bonds in some investment grade ETFs are "pre-junk," with a triple B rating. Real estate has been bid up in many markets to unsustainable levels...and the list goes on.

The failed IPO of WeWork is an indication that investors are starting to wake up to the realization that risk exists and deserves respect

Many unicorns (a privately held company valued at over $1 billion) have been faltering this year. A few have performed well, but a lot of them are underwater. Investors are finally catching on that there are no guarantees and risk matters. At some point the process of "risk realization" will spread. Opportunities still exist in the market, but greater care in selection will be needed to be successful in the future.